Grand Canyon Education, Inc.
Form 10-Q
August 03, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2009

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File Number: 001-34211

GRAND CANYON EDUCATION, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	**20-3356009**
(State or other jurisdiction of Incorporation or organization)	***(I.R.S. Employer Identification No.)***

3300 W. Camelback Road
Phoenix, Arizona 85017
(Address, including zip code, of principal executive offices)
(602) 639-7500
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer þ (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

The total number of shares of common stock outstanding as of July 30, 2009, was 44,595,794.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

GRAND CANYON EDUCATION, INC.
Statements of Operations

(In thousands, except per share amounts)	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	Unaudited			
Net revenue	$ 59,400	$ 34,566	$ 118,364	$ 70,275
Costs and expenses:				
Instructional costs and services	20,047	12,408	38,379	24,028
Selling and promotional, including $1,779 and $1,413 for the three months ended June 30, 2009 and 2008, respectively, and $3,391 and $2,925 for the six months ended June 30, 2009 and 2008, respectively, to related parties	20,631	14,887	40,301	27,473
General and administrative	8,688	6,419	17,521	10,960
Royalty to former owner	74	466	148	1,488
Total costs and expenses	49,440	34,180	96,349	63,949
Operating income	9,960	386	22,015	6,326
Interest expense	(420)	(694)	(1,087)	(1,507)
Interest income	121	179	229	432
Income (loss) before income taxes	9,661	(129)	21,157	5,251
Income tax expense (benefit)	3,846	(49)	8,439	2,027
Net income (loss)	5,815	(80)	12,718	3,224
Preferred dividends		(268)		(521)
Net income (loss) available to common stockholders	$ 5,815	$ (348)	$ 12,718	$ 2,703
Net income (loss) per common share:				
Basic	$ 0.13	$ (0.02)	$ 0.28	$ 0.14
Diluted	$ 0.13	$ (0.02)	$ 0.28	$ 0.08
Shares used in computing net income (loss) per common share:				
Basic	44,846	19,142	45,159	19,089
Diluted	45,051	19,142	45,437	32,623

The accompanying notes are an integral part of these financial statements.

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GRAND CANYON EDUCATION, INC.
Balance Sheets

(In thousands, except share data)	June 30, 2009 (Unaudited)	December 31, 2008
ASSETS:		
Current assets		
Cash and cash equivalents	$ 24,742	$ 35,152
Restricted cash and cash equivalents	6,230	2,197
Accounts receivable, net of allowance for doubtful accounts of $7,110 and $6,356 at June 30, 2009 and December 31, 2008, respectively	10,612	9,442
Income taxes receivable	1,398	1,576
Deferred income taxes	3,087	2,603
Other current assets	2,330	2,629
Total current assets	48,399	53,599
Property and equipment, net	58,146	41,399
Restricted cash and investments (of which $0 and $2,928 is restricted at June 30, 2009 and December 31, 2008, respectively)	483	3,403
Prepaid royalties	7,677	8,043
Goodwill	2,941	2,941
Deferred income taxes	8,216	7,404
Other assets	644	201
Total assets	$ 126,506	$ 116,990
LIABILITIES AND STOCKHOLDERS EQUITY:		
Current liabilities		
Accounts payable	$ 9,753	$ 5,770
Accrued liabilities	11,178	9,674
Income taxes payable	67	172
Deferred revenue and student deposits	20,183	14,262
Due to related parties	1,666	1,197
Current portion of capital lease obligations	801	1,125
Current portion of notes payable	2,108	357
Total current liabilities	45,756	32,557
Capital lease obligations, less current portion	1,212	29,384
Notes payable, less current portion and other	25,573	1,459
Total liabilities	72,541	63,400
Commitments and contingencies		
Stockholders equity		
Preferred stock, $0.01 par value, 10,000,000 shares authorized; 0 shares issued and outstanding at June 30, 2009 and December 31, 2008		
Common stock, $0.01 par value, 100,000,000 shares authorized; 44,576,417 and 45,465,160 shares issued and outstanding at June 30, 2009 and December 31, 2008,	446	455

respectively				
Additional paid-in capital		52,469		64,808
Accumulated other comprehensive income		21		16
Accumulated earnings (deficit)		1,029		(11,689)
Total stockholders equity		53,965		53,590
Total liabilities and stockholders equity	$	126,506	$	116,990

The accompanying notes are an integral part of these financial statements.

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GRAND CANYON EDUCATION, INC.
Statement of Stockholders Equity
(In thousands, except share data)
(Unaudited)

	Common Stock Shares	Common Stock Par Value	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Earnings (Deficit)	Total
Balance at December 31, 2008	45,465,160	$ 455	$ 64,808	$ 16	$ (11,689)	$ 53,590
Net income					12,718	12,718
Unrealized losses on available for-sale securities, net of taxes of $3				5		5
Comprehensive income						12,723
Share-based compensation			1,577			1,577
Exercise of stock options	20,605		247			247
Excess tax benefits from share-based compensation			323			323
Repurchase and retirement of shares of the Company s common stock	(909,348)	(9)	(14,486)			(14,495)
Balance at June 30, 2009	44,576,417	$ 446	$ 52,469	$ 21	$ 1,029	$ 53,965

The accompanying notes are an integral part of these financial statements.

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GRAND CANYON EDUCATION, INC.
Statements of Cash Flows

(In thousands)	Six Months Ended June 30, 2009	2008
	(Unaudited)	
Cash flows provided by (used in) operating activities:		
Net income	$ 12,718	$ 3,224
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Share-based compensation	1,577	
Excess tax benefits from share-based compensation	(9)	
Provision for bad debts	6,587	4,052
Depreciation and amortization	3,386	2,269
Deferred income taxes	(1,296)	(186)
Other	(14)	(112)
Changes in assets and liabilities:		
Accounts receivable	(7,757)	(3,868)
Prepaid expenses and other	333	(266)
Due to/from related parties	469	288
Accounts payable	2,942	619
Accrued liabilities	1,729	576
Income taxes receivable/payable	396	1,405
Deposit with former owner		3,000
Royalty payable to former owner		(7,428)
Prepaid royalties to former owner		(5,920)
Deferred revenue and student deposits	5,921	604
Net cash provided by (used in) operating activities	26,982	(1,743)
Cash flows used in investing activities:		
Capital expenditures	(11,111)	(3,504)
Purchase of campus land and buildings	(35,505)	
Change in restricted cash and cash equivalents	(1,108)	2,064
Purchases of investments		(2,499)
Proceeds from sale or maturity of investments		2,470
Net cash used in investing activities	(47,724)	(1,469)
Cash flows provided by (used in) financing activities:		
Principal payments on notes payable and capital lease obligations	(976)	(719)
Proceeds from debt	25,547	
Repurchase of common shares	(14,495)	
Repayment on line of credit		(6,000)
Proceeds from related party payable on preferred stock		5,725
Repurchase of Institute Warrant		(6,000)
Repurchase of Institute Note Payable		(1,250)
Amount paid related to initial public offering		(2,484)
Excess tax benefits from share-based compensation	9	

Net proceeds from exercise of stock options		247		
Net cash provided by (used in) financing activities		10,332		(10,728)
Net decrease in cash and cash equivalents		(10,410)		(13,940)
Cash and cash equivalents, beginning of period		35,152		18,930
Cash and cash equivalents, end of period	$	24,742	$	4,990
Supplemental disclosure of cash flow information				
Cash paid for interest	$	1,276	$	2,382
Cash paid for income taxes	$	9,402	$	762
Supplemental disclosure of non-cash investing and financing activities				
Purchase of equipment through notes payable and capital lease obligations	$	2,116	$	760
Purchases of property and equipment included in accounts payable	$	1,041	$	479
Settlement of capital lease obligation	$	30,020	$	
Tax benefit of Spirit warrant intangible	$	314	$	
Value assigned to Blanchard shares	$		$	2,996
Assumption of future obligations under gift annuities	$		$	887
Accretion of dividends on Series C convertible preferred stock	$		$	521

The accompanying notes are an integral part of these financial statements.

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GRAND CANYON EDUCATION, INC.
Notes to Financial Statements
(In thousands, except share and per share data)
(Unaudited)

1. Nature of Business

Grand Canyon Education, Inc. (the Company) is a regionally accredited provider of online postsecondary education services focused on offering graduate and undergraduate degree programs in its core disciplines of education, business, and healthcare. In addition to online programs, the Company offers courses at its campus in Phoenix, Arizona and onsite at the facilities of employers. The Company is accredited by The Higher Learning Commission of the North Central Association of Colleges and Schools.

2. Summary of Significant Accounting Policies

Unaudited Interim Financial Information

The accompanying unaudited interim financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles, consistent in all material respects with those applied in its financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2008. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. Such interim financial information is unaudited but reflects all adjustments that in the opinion of management are necessary for the fair presentation of the interim periods presented. Interim results are not necessarily indicative of results for a full year. This Quarterly Report on Form 10-Q should be read in conjunction with the Company s financial statements and footnotes included in its Annual Report on Form 10-K for the year ended December 31, 2008.

Revenue Recognition

Net revenues consist primarily of tuition and fees derived from courses taught by the Company online, at its traditional campus in Phoenix, Arizona, and onsite at facilities of employers, as well as from related educational resources such as access to online materials. Tuition revenue and most fees and related educational resources are recognized monthly over the applicable period of instruction, net of scholarships provided by the Company.

Derivatives and Hedging

Derivative financial instruments are recorded on the balance sheet as assets or liabilities and re-measured at fair value at each reporting date. For derivatives designated as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or period during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

Derivative financial instruments enable the Company to manage its exposure to interest rate risk. The Company does not engage in any derivative instrument trading activity. Credit risk associated with the Company s derivatives is limited to the risk that a derivative counterparty will not perform in accordance with the terms of the contract. Exposure to counterparty credit risk is considered low because these agreements have been entered into with major credit-worthy institutions with strong credit ratings, and they are expected to perform fully under the terms of the agreements.

On June 30, 2009, the Company entered into two derivative agreements to manage its 30 Day LIBOR interest exposure related to its variable rate debt, which commenced in April 2009 until maturity in April 2014. The fair value of the corridor derivative asset as of June 30, 2009 was $164 and is included in Other assets. The fair value of the forward starting interest rate swap is $0 as of June 30, 2009. These derivative instruments were designated and formally documented as cash flow hedges of variable rate debt obligations.

The corridor instrument hedges variable interest rate risk starting July 1, 2009 through April 30, 2014 with a notional amount of $12,695 as of June 30, 2009. The corridor instrument permits the Company to hedge its interest rate risk at several thresholds; the Company will pay variable interest rates based on the 30 Day LIBOR rates monthly until that index reaches 4%. If 30 Day LIBOR is equal to 4% through 6%, the Company will pay 4%. If 30 Day LIBOR exceeds 6%, the Company will pay actual 30 Day LIBOR less 2%. This reduces the Company s exposure to potentially increased interest rate risk.

The forward starting interest rate swap commences on May 1, 2010 and continues each month thereafter until April 30, 2014 and has an initial notional amount of $11,982. The Company will receive 30 Day LIBOR and pay 3.245% fixed interest on the amortizing notional amount. Therefore, the Company has hedged its exposure to future variable rate cash flows in the future through April 30, 2014.

As of June 30, 2009 no derivative ineffectiveness was identified. Any ineffectiveness in the Company s derivative instruments designated as hedges would be reported in Interest expense in the statement of operations.

Fair Value of Financial Instruments

As of June 30, 2009, the carrying value of cash and cash equivalents, accounts receivable, account payable and accrued expenses approximate their fair value based on the liquidity or the short-term maturities of these instruments. The carrying value of debt approximates fair value as it is based on variable rate index. The carrying value of capital lease obligations approximate fair value based upon market interest rates available to the Company for debt of similar risk and maturities. The fair value of investments was determined using Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurements, Level 1 of the hierarchy of valuation inputs, with the use of observable market prices in the active market. The Company s investment portfolio is primarily comprised of money market funds with AAA rating at more than one financial institution. Derivative financial instruments are carried at fair market value, determined using Level 2 of the hierarchy of valuation inputs, with the use of inputs other than quoted prices that are observable for the asset or liability.

Comprehensive Income

Total comprehensive income includes net income and other comprehensive income (loss), which consists solely of unrealized gains and losses on available-for-sale investments. Total comprehensive income for the six months ended June 30, 2009 and 2008 was $12,723 and $3,155, respectively.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates.

GRAND CANYON EDUCATION, INC.
Notes to Financial Statements
(In thousands, except share and per share data)
(Unaudited)

Segment Information

The Company operates as a single educational delivery operation using a core infrastructure that serves the curriculum and educational delivery needs of both its ground and online students regardless of geography. The Company s chief operating decision maker manages the Company s operations as a whole and no expense or operating income information is generated or evaluated on any component level.

Reclassifications

Certain reclassification of prior year amounts have been made to the prior year balances to conform to the current period.

Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued Financial Statement Position (FSP) No. FAS 107-1 and Accounting Principal Board (APB) No. 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB 28-1). This statement increases the frequency of fair value disclosures from annual only to quarterly. FSP FAS 107-1 and APB 28-1 is effective for interim periods ending after June 15, 2009 and is effective for the Company with respect to this Form 10-Q. The Company s adoption of FSP FAS 107-1 and APB 28-1 did not have a material impact on its financial condition, results of operations or disclosures.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events (SFAS No. 165), which provides guidance for management of reporting entities relating to the accounting for and disclosures of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. SFAS No. 165 requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for the date selection. SFAS No. 165 is effective for interim and annual periods ending after June 15, 2009. Management has evaluated subsequent events for this interim reporting period through August 3, 2009. Given the centralization of operations and location of key management personnel, the Company believes this is a reasonable date through which to evaluate subsequent events. The adoption of SFAS No. 165 did not have an impact on the Company s financial condition, results of operations or disclosures.

In June 2009, the FASB approved the FASB Accounting Standards Codification (Codification) as the single authoritative source for United States Generally Accepted Accounting Principles (U.S. GAAP). The Codification, which was launched on July 1, 2009, does not change current U.S. GAAP, but is intended to simplify user access by providing all authoritative U. S. GAAP in one location. All existing accounting standard documents will be superseded and all other accounting literature not included in the Codification will be considered nonauthoritative. The Codification is effective for interim and annual periods ending after September 15, 2009. The Codification is effective for the Company for the interim period ending September 30, 2009 and will not have an impact on the Company s financial condition or results of operations.

3. Spirit Transaction

On April 28, 2009, the Company acquired the land and buildings that comprise its ground campus and 909,348 shares of its common stock from Spirit Master Funding, LLC and Spirit Management Company, respectively (collectively, Spirit) for an aggregate purchase price of $50,000. Prior to the acquisition, the Company had leased the land and buildings from Spirit, accounting for the land as an operating lease and the buildings and improvements as capital lease obligations. To finance a portion of the purchase, the Company entered into a loan agreement with a financial institution pursuant to which it borrowed $25,675. Under the terms of the loan agreement, the Company will make principal payments in equal monthly installments of $143 plus accrued interest at 30 day LIBOR plus 3.5% (approximately 3.82% at June 30, 2009). All remaining unpaid principal is due on April 30, 2014. The loan agreement contains standard covenants, including covenants that, among other things, restrict the Company s ability to incur additional debt or make certain investments, require the Company to maintain compliance with certain applicable regulatory standards, and require the Company to maintain a certain financial condition. Indebtedness under the loan agreement is secured by the land and buildings that comprise the Company s ground campus. As of June 30, 2009, the

Company is in compliance with its debt covenants.
The Company allocated $14,495 of the purchase price to the repurchase of its common stock and the remaining $35,505 to the land and buildings. Additionally, the Company removed the building and improvement assets and related capital lease obligations of $29,796 and applied the deferred gain of $1,429 as a reduction to the new building value.

4. Earnings Per Share

Basic earnings per common share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per common share reflects the assumed conversion of all potentially dilutive securities, consisting of stock options, preferred stock and common stock warrants for which the estimated fair value exceeds the exercise price, less shares which could have been purchased with the related proceeds, unless anti-dilutive. For employee equity awards, repurchased shares are also included for any unearned compensation adjusted for tax.

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GRAND CANYON EDUCATION, INC.
Notes to Financial Statements
(In thousands, except share and per share data)
(Unaudited)

The table below reflects the calculation of the weighted average number of common shares outstanding, on an as if converted basis, used in computing basic and diluted earnings per common share.

	Three Months Ended June 30,		Six Month Ended June 30,	
	2009	2008	2009	2008
Denominator:				
Basic common shares outstanding	44,846,224	19,142,399	45,158,536	19,089,004
Effect of dilutive preferred stock				10,870,178
Effect of dilutive warrants and contingently issuable common stock				2,625,788
Effect of dilutive stock options and restricted stock	204,395		278,388	38,346
Diluted common shares outstanding	45,050,619	19,142,399	45,436,924	32,623,316

For the three months ended June 30, 2008, approximately 10,870,178 shares of preferred stock and 1,382,126 of warrants were excluded from the calculation of diluted earnings per share as their inclusion would have been anti-dilutive given the net loss.

5. Valuation and Qualifying Accounts

	Balance at Beginning of Year	Charged to Expense	Deductions(1)	Balance at End of Period
Allowance for doubtful accounts receivable:				
Six months ended June 30, 2009	$ 6,356	6,587	(5,833)	$ 7,110
Six months ended June 30, 2008	$ 12,158	4,052	(768)	$ 15,442

(1) Deductions represent accounts written off, net of recoveries.

6. Accrued Liabilities

Accrued liabilities consist of the following:

	June 30, 2009	December 31, 2008
Accrued compensation and benefits	$ 7,317	$ 5,340
Accrued interest	94	284
Deferred rent	39	34
Tax reserves, non-income tax related	233	710

FIN 48 accrual	244	299
Other accrued expenses	3,251	3,007
	$ 11,178	$ 9,674

7. Commitments and Contingencies

Leases

The Company leases certain land, buildings and equipment under non-cancelable operating leases expiring at various dates through 2015. Future minimum lease payments under operating leases due each year are as follows at June 30, 2009: